No. 82-1565

In the Supreme Court of the United States

OCTOBER TERM, 1983

BACCHUS IMPORTS, LTD., and
EAGLE DISTRIBUTORS, INC., *Appellants*,

vs.

GEORGE FREITAS, DIRECTOR OF TAXATION
OF THE STATE OF HAWAII, *Appellee*.

**On Appeal from the Supreme Court
of the State of Hawaii**

REPLY BRIEF FOR THE APPELLANTS

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I. APPELLEE ABANDONS THE GROUNDS OF THE STATE COURT AND RAISES NEW ARGUMENTS THAT ARE NOT PROPERLY PRESERVED

Appellee's brief in this case is a confession and avoidance.

It is a confession because appellee abandons the grounds the Supreme Court of Hawaii used to sustain this statute. That court held the statute constitutional because "the promotion of domestic industry is a legitimate state purpose" (J. S. App. A-13), because appellants' freedom to sell untaxed Hawaiian okolehao, wine, and rum made discrimination against out-of-state products irrelevant (*id.* at A-25), and because the tax was "fairly apportioned" (*id.* at A-27 to A-30). Appellee all but concedes that the first of these is more damnation than defense, because protection of in-state products is condemned under the Commerce Clause by a rule of per se unconstitutionality. Appellee repudiates the second ground (Br. 30 n.21) and does not mention the third, implicitly conceding its irrelevance.

It is an avoidance because appellee fires a fusillade of arguments that have little to do with the merits. Appellee argues that the statute is only a little bit discriminatory, because Hawaii does not produce much okolehao or fruit wine, and small discriminations should be overlooked (Br. 28-30, 40-46). Appellee maintains that the wholesalers of wine are not entitled to refunds because they "passed on" the tax (Br. 10-14), that the tax exemptions are severable and thus the wholesalers cannot seek refunds (Br. 15-19), that any decision should not be applied to benefit these wholesalers (Br. 19-22), and that the size of the taxes wrongfully collected is so large that the state should not be required to repay (Br. 46-49). Appellee also introduces two new arguments on the merits: that the Twenty-first Amendment supports the tax (Br. 35-40) and that because a tax exemption is like a subsidy, a series of recent cases supports the discrimination (Br. 31-34).

These arguments were not made below, not passed on below, or both. Their status here is accordingly questionable. This Court has construed 28 U. S. C. § 1257, which supplies its jurisdiction in this case, as denying it the *power* to rule on grounds of decision that were not properly presented and preserved in the state court. E.g., *McGoldrick* v. *Compagnie General Transatlantique,* 309 U. S. 430, 433-35 (1940) (a constitutional argument invoked in support of a judgment, but not properly preserved in the state court, is outside this Court's jurisdiction); *Cardinale* v. *Louisiana,* 394 U. S. 437 (1969); *Webb* v. *Webb,* 451 U. S. 493 (1981). Although a party need not assert his arguments using any magic formula, see *Eddings* v. *Oklahoma,* 455 U. S. 104, 113-14 n. 9 (1981), he must at least assert the outlines and basic support of the argument. "The State as respondent may make any argument *presented below* that supports the judgment of the lower court", *Hankerson* v. *North Carolina,* 432 U. S. 233, 240 n.6 (1977) (emphasis added), but may not advance new grounds. We discuss below which of appellee's arguments were preserved.

II. THE PER SE RULE AGAINST PROTECTIONISM GOVERNS THIS CASE

States may not use the tax system to discriminate against products from out of state. The Commerce Clause implements this principle when the products come from other states; the Foreign Commerce and Import-Export Clauses implement it when the products come from abroad. Each clause establishes a per se rule that states may not favor their own products. E.g., *Boston Stock Exchange* v. *State Tax Commission,* 429 U.S. 318, 328-35 (1977); *Michelin Tire Corp.* v. *Wages,* 423 U.S. 276, 288 & n.7 (1976); *Dep't of Revenue* v. *James B. Beam Distilling Co.,* 377 U.S. 341 (1964).

A. The Subsidy Cases do not Support Hawaii's Scheme

Appellee attempts to avoid this antidiscrimination principle by observing that states may subsidize local products and producers; appellee argues from this (Br. 31-34) that the tax exemption is equivalent to a subsidy and should be sustained. Although appellee did not raise this equivalence argument in the state court, we address it here out of concern that this Court may treat it as an elaboration of appellee's earlier arguments rather than a new argument.

Doubtless a state may subsidize local industry and local residents. The state raises taxes from its residents, and it need not spread the benefits indiscriminately among residents of other states who did not contribute to the fund that produced the benefits. E.g., *White* v. *Massachusetts Council of Construction Employers,* 459 U. S. ___ (No. 81-1003, Feb. 28, 1983); *Reeves, Inc.* v. *Stake,* 447 U. S. 429 (1980). It is also true that under some circumstances a tax exemption amounts to a subsidy. E.g., *Bob Jones University* v. *United States,* 461 U. S. ___ (No. 81-1, May 24, 1983); *Committee for Public Education* v. *Nyquist,* 413 U. S. 756 (1973). It does not follow, however, that whenever a state may support local residents through a subsidy it may do so through a tax exemption.

White, Reeves, and similar cases are based on a distinction between the state as participant in a market and the state as regulator of a market. As participant, the state may direct benefits toward residents. Were it otherwise, the federal nature of society would be destroyed: a state could not offer free education (or any other benefit) to its own residents without subsidizing residents of other states too. The rationale establishing that a state must be allowed to use its revenues in favor of its residents does not carry over to the state's role as regulator or tax collector. *Hughes* v. *Alexandria Scrap Corp.,* 426 U. S. 794, 809-10 & n.20 (1976). Requiring evenhanded taxation does not disable the state from serving as a government to its people. An unbroken line of cases establishes that Hawaii cannot levy taxes on foreign products unless it levies equal taxes on domestic products.[1]

B. There is no De Minimis Exception to the Antidiscrimination Principle

Appellee's principal argument on the merits (Br. 28-30, 40-46) is that a state may discriminate in favor of local business, so long as it does not discriminate very much. At first glance the discrimination here appears to be quite large: the difference between a tax of 20% on wine from California and no tax on wine from Hawaii easily can be $56.40 per case (McKesson Br. 25-27, showing derivation from stipulation of facts). The refunds sought by the appellants exceed $10 million (JA 7, 13). There can be no doubt that wine and brandy from outside Hawaii labored under a substantial disadvantage compared with products made in Hawaii.

[1] One important reason for the distinction between taxes and subsidies is that they often have a different economic incidence. A subsidy comes from revenues in the state's treasury, revenues that will inure to the benefit of the state's residents one way or the other. A discriminatory tax, on the other hand, often falls on residents of other states. The tax in this case reduced the volume of sales of wines and liquors from California and France, and it reduced the markups of the wholesalers who had to reduce their price to compensate for the tax. The economic incidence is hard to determine with precision (see the discussion *infra*), but it is certain that some of the cost is borne outside Hawaii. Preventing the exportation of taxes is one of the principal purposes of the Commerce Clause.

Appellee asks the Court to look from a different perspective. Okolehao and pineapple wine are not made outside Hawaii. They were not sold in large volumes; according to appellee (Br. App. A-1) they represented less than one percent of all liquor sold in Hawaii. Consequently, appellee maintains, the preference for Hawaii products could not do "very much" damage to products from out of state, and the discrimination should be excused.[2]

Perhaps there would be substance to appellee's argument if the state had levied a tax on alcohol and exempted alcohol in after-shave lotion made in Hawaii. Then the alcoholic beverages sold by appellants really would not compete with the products of Hawaii. But the state's tax applies to "liquor," which the statute defines to include okolehao, wine, and all other alcoholic beverages (Haw. Rev. Stat. § 281-1, quoted at n.1 of our opening brief). The State has established the category within which competition occurs.

There is little doubt that okolehao and fruit wine compete with the non-Hawaii beverages appellants sell. Okolehao is a brandy, which competes with other specialty drinks such as cognac and Benedictine (a flavored brandy). The legislative history of the tax exemption indicates that Hawaii was attempting to boost Hawaiian okolehao to the same sort of market position now occupied by Mexican tequila. Haw. Stand. Comm. Rep. No. 246, 6th Legis. (1971) (see McKesson Br. App. A-3). Pineapple wine has no distinctive pineapple taste; it competes with wines made from other fruits (apples and pears as well as grapes). Wines of all sorts compete; a sweet sauterne does not taste like a dry fume blanc, but the two nonetheless are in the same market. When the state legislature enacted the tax

[2] Appellee also contends that the lack of substantial effect on foreign goods shows that the statute is a beneficent preference for a struggling local industry rather than a malign effort to "get" foreign producers (Br. 8, 40-42). The Court need not impugn Hawaii's motives to recognize that creating a preference for local industry and imposing a detriment on industry elsewhere are two sides of the same coin. There cannot be a preference without a detriment. It is therefore pointless to debate whether Hawaii's motives were or were not pure. The per se rule against discrimination applies whichever characterization of the motive is most appropriate.

preference, it anticipated the development of a grape wine business as well as a pineapple wine business (which is why the exemption covers "fruit wine"). Although the difficulty of raising in Hawaii grapes suitable for wine delayed the production of that beverage, grape wine is now made there.[3]

It may be true, as appellee emphasizes, that despite the 20% price advantage created by the discriminatory tax, okolehao and pineapple wine have not prospered in competition with liqueurs and wines from California or France. By appellee's reasoning, Hawaii is entitled to make the tax difference higher and higher until, at some point (perhaps a 50% price difference), Hawaiian products claim a significant part of the market. There must come a point at which they will do so. Then the state may maintain the tax difference at that level (or perhaps a few percent less) indefinitely, so long as the home-grown product does not claim "too high" a percentage of the sales.

It does not take extended argument to show that a state may not justify such a preference on the ground that it is "not too big," or that it is "reasonable," or appropriate under some other formula. The constitutional command is that the nation be a single free-trade zone. States may not prefer local goods just because they will not sell in the absence of protectionism. There is no "acceptable" level of Balkanization via discriminatory taxes. The only constitutionally-acceptable level of tax discrimination is zero.[4]

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[3] Similarly, rum distilled in Hawaii, the subject of an exemption enacted in 1981, competes with rum distilled elsewhere. A great deal of rum is imported into Hawaii, and the domestic Hawaiian industry has burgeoned under its tax shelter.

[4] This Court's cases do not hint at an exception for small differences in the treatment of out-of-state products. E.g., *Maryland* v. *Louisiana*, 451 U. S. 725, 759-60 (1981); *Boston Stock Exchange, supra*, 429 U. S. at 334 & n. 13 (discrimination is impermissible even if small); *Memphis Steam Laundry Cleaner, Inc.* v. *Stone*, 342 U. S. 389 (1952) (difference between tax of $8 on in-state business and $50 on out-of-state business is unconstitutional); *Best & Co.* v. *Maxwell*, 311 U. S. 454 (1940) (tax of $250 on out-of-state merchants is unconstitutional even though some in-state merchants pay the same tax); *Walling* v. *Michigan*, 116 U. S. 446 (1886) (tax of $300 per agent on merchants that import liquor from out of state is unconstitutional, even

Footnote continued on following page.

III. THE TWENTY-FIRST AMENDMENT DOES NOT REQUIRE THAT THE COMMERCE CLAUSE BE REINTERPRETED TO COUNTENANCE DISCRIMINATION AGAINST PRODUCTS FROM OUT OF STATE

Appellee argues (Br. 30-35) that discriminatory taxation of alcoholic beverages may be sustained under the Twenty-first Amendment even if it would be a violation of the Constitution with respect to other products. This argument was not presented to the Supreme Court of Hawaii, and that court did not mention the Twenty-first Amendment. Indeed, appellee's brief in the court below expressly declined to rely on the Twenty-first Amendment. Accordingly, if the Twenty-first Amendment is invoked as a new ground in support of the judgment below, it is outside the jurisdiction of this Court. See page 2, *supra*.

Perhaps, however, appellee invokes the Twenty-first Amendment only for assistance in the interpretation of the other portions of the Constitution on which we rely. This Court's decisions suggest that the Twenty-first Amendment plays a role in the construction of these other provisions even when it does not override them. E.g., *California Retail Liquor Dealers Ass'n* v. *Midcal Aluminum, Inc.*, 445 U. S. 97, 106-14 (1980); *Hostetter* v. *Idlewild Bon Voyage Liquor Corp.*, 377 U. S. 324, 332 (1964). Issues concerning the proper application of the Commerce, Foreign Commerce, and Import-Export Clauses to the taxation of liquor were presented below and consequently are within this Court's jurisdiction even though appellee did not present in the state courts all of the arguments he offers in this Court. As a matter of prudence, therefore, we address the Twenty-first Amendment issues raised by appellee.

Footnote continued from preceding page.

though merchants that sell domestic liquor are taxed $500, because some merchants have multiple agents); *Guy* v. *Baltimore*, 100 U. S. 434 (1879) (wharfage fee of $4.40 on a cargo of potatoes from another state is unconstitutional because no identical fee is levied if cargo is from within the state).

To understand the bearing of the Twenty-first Amendment on the Commerce Clause argument, one must start with the purposes served by this Court's decisions prohibiting discriminatory taxation. The Court has held repeatedly that the Commerce Clause preserves a zone of free trade and protects the Nation from Balkanization. E.g., *Boston Stock Exchange, supra,* 429 U. S. at 328-29; *Welton* v. *Missouri,* 91 U. S. 275, 278-81 (1875). When Congress has used its Commerce Power to regulate part of a field but not the rest, the Court infers that Congress meant that the rest of the field be left open to free trade. When Congress has left the field entirely free of regulation, the Court draws the same inference. Congress may authorize states to go their separate ways, but to do this Congress must speak clearly.[5] Because the principal purpose of the Commerce Clause was to grant powers to Congress, the whole "dormant Commerce Clause" jurisprudence rests on a series of inferences about the meaning of Congressional action and inaction. No matter what, the decisions of Congress govern.

The Twenty-first Amendment grants states regulatory powers over commerce that they lacked while the "original package doctrine" of *Low* v. *Austin,* 13 Wall. (80 U. S.) 29 (1872), reigned. *Low* held that so long as goods from out of state remained in their original packages, states could not regulate or tax them. This made it difficult or impossible for states to close their borders to liquor, because importers could deliver liquor in the original package direct to the consumer. The Twenty-first Amendment ensured that, no matter what interpretation this Court might place on the Commerce Clause in the future, states could freely choose to be "dry" and could regulate liquor arriving from out of state in the same way they

[5] The court below relied (J. S. App. A-13) on one of the cases of express authorization, *Western & Southern Life Ins. Co.* v. *State Board of Equalization,* 451 U. S. 648 (1981), for the proposition that it is legitimate for a state to favor domestic products. This Court held no such thing. It said, rather, that "promotion of domestic industry *by deterring barriers to interstate business* is a legitimate state purpose" (*id.* at 671, emphasis added).

regulated other liquor. Our opening Br. 29-40 and the Wine Institute Br. 11-26 discuss the legislative history of the Twenty-first Amendment in detail.

Yet the Twenty-first Amendment does not withdraw any powers of Congress under the Commerce Clause. Indeed, the history of the Twenty-first Amendment strongly suggests that it was designed to confirm the constitutionality of two statutes, the Wilson Act of 1890, 27 U. S. C. § 121, and the Webb-Kenyon Act of 1913, 27 U. S. C. § 122, that had *exercised* the Commerce Power by allowing states to close their borders to liquor. See *Clark Distilling Co.* v. *Western Maryland Ry.*, 242 U. S. 311 (1917) (sustaining the Webb-Kenyon Act); *Scott* v. *Donald*, 165 U. S. 58 (1897) (sustaining the Wilson Act). Immediately after the effective date of the Twenty-first Amendment, in reliance on the Commerce Power, Congress enacted the Federal Alcohol Administration Act, 27 U. S. C. §§ 201-12, which contains a battery of liquor control devices. These include licensing and labeling requirements, taxes, and rules for the conduct of business. Since that time the Court has applied these statutes without constitutional scruple (e.g., *Rice* v. *Norman Williams Co.*, 458 U. S. 654 (1982)), has sustained them when attacked under the Twenty-first Amendment (e.g., *Idlewild Bon Voyage Liquor, supra*), and has sustained other statutes enacted before the Twenty-first Amendment (e.g., *Midcal, supra,* holding that the Sherman Act preempts a state liquor-control statute).

So long as Congress remains free to exercise its Commerce Power to prevent Balkanization, it is also appropriate for this Court to continue to infer that Congressional silence means that states may not discriminate. It is true that a few cases stated that the Twenty-first Amendment allows states to discriminate against products from outside their borders. E.g., *State Board of Equalization* v. *Young's Market Co.*, 299 U. S. 59 (1936) (disparate license fees); *Mahoney* v. *Joseph Triner Corp.*, 304 U. S. 401 (1938). But these cases did not consider the genesis of the rule against discriminatory taxation or discuss the relation between federal and state power. They did not discuss the history of the Twenty-first Amendment either, deeming the

language too "clear" to permit inquiry into purposes and functions. Later cases that have discussed these dispositive issues have uniformly held that state authority under the Twenty-first Amendment does not displace federal authority. E.g., *Midcal, supra; Idlewild Bon Voyage, supra; James B. Beam, supra; United States* v. *State Tax Comm'n,* 412 U. S. 599 (1975) (federal enclaves); *Craig* v. *Boren,* 429 U. S. 190 (1976) (Fourteenth Amendment).[6]

This argument is sufficient to establish that unexercised federal power would be enough to prevent states from enacting protectionist legislation, at least when the state does not invoke an interest in temperance or in raising revenue. The statute challenged here does neither: the tax exemption for local products does not raise revenue, and because the exemption reduces the price of local products, it does not promote temperance either. Neither the language nor the history of the Twenty-first Amendment indicates that it recognizes any interest in provincialism or authorizes the states to favor domestic products. When the interests served by the Twenty-first Amendment are inapplicable, the state's power lapses and the ordinary principles of free trade prevail. *Midcal, supra,* 445 U. S. at 112-14.

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[6] Cases such as *Young's* not only omit consideration of Congressional power but also rest on a form of argument that has long since been discarded. The cases start from the premise that the Twenty-first Amendment grants power to states and then reason that the greater power to exclude liquor necessarily includes the lesser power to tax or discriminate. This greater-includes-the-lesser argument led the Court to say in *Young's* that a "classification recognized by the Twenty-first Amendment cannot be deemed forbidden by the Fourteenth." 299 U. S. at 64. The problem with this line of argument is that it proves far too much. Greater-includes-the-lesser arguments imply that a state with the power to go dry also could limit liquor licenses to whites (or to people who vow to refrain from criticizing the government), could have different drinking ages for men and women, could tax U. S. and Scotch liquor at different rates, could authorize resale price maintenance or other violations of the antitrust laws, and on and on and on. This Court has rejected each of these implications, in cases such as *Craig* v. *Boren, James B. Beam,* and *Midcal.* These more recent cases so thoroughly undercut the rationale of *Young's* and similar cases that it may be most appropriate for the Court to acknowledge that the earlier cases are no longer to be followed.

More importantly, federal power is not unexercised. The Wilson Act expressly precludes states from discriminating. The Wilson Act, enacted in 1890 and still in force (see *Idlewild Bon Voyage, supra,* 377 U. S. at 333 n. 11; *James B. Beam, supra,* 377 U. S. at 345 n. 7), provides that a state may regulate alcoholic beverages "to the same extent and in the same manner as though such liquids or liquors had been produced in such State" (27 U. S. C. § 121). This Court held in *Scott* v. *Donald, supra,* 165 U. S. at 100, that "the State cannot, under the [Wilson Act] ..., establish a system which, in effect, discriminates between interstate and domestic commerce in commodities ... which are admitted to be lawful." If the Wilson Act is a constitutional exercise of Congress's power, then the Hawaii system of discriminatory taxes cannot stand. Appellee does not challenge the constitutionality of the Wilson Act, and the state's argument therefore fails.

IV. THE WHOLESALERS ARE ENTITLED TO REFUNDS OF THE DISCRIMINATORY TAXES WHETHER OR NOT THEY PASSED THE TAXES ON

Although we have completed our discussion of the merits, appellee's brief is addressed principally to collateral issues. Using a variety of arguments, appellee maintains that even if Hawaii's system of taxation is unconstitutional the appellants are not entitled to relief. We take these arguments up in order, starting with the contention (Br. 5, 10-14) that wholesalers of liquor are not entitled to refunds because they "passed on" the taxes wrongfully exacted from them.

As we developed in our Brief in Opposition to Appellee's Motion to Dismiss or Remand (which this Court denied on December 12), the passing-on argument was not raised below and therefore is not within this Court's jurisdiction. See also page 2, *supra.*

There is no colorable argument that the appellants lack standing, so that Article III of the Constitution precludes this Court from addressing the merits. This is a suit for recovery of taxes paid. There is a concrete case or controversy. Appellants

stand to recover more than $10 million in taxes paid.[7] A plaintiff has standing even though he ultimately may not get what he seeks, perhaps because of a decision to equalize tax burdens by increasing the taxes of others. *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U. S. 522, 525-26 (1959). The appellants thus have standing.

The "passing-on" defense now asserted by appellee must be one arising under state law rather than Article III. Appellee apparently maintains that the consumers or retailers, rather than the wholesalers, are the appropriate persons to recover the tax. (All of the refund cases cited by appellee at Br. 11-12 n. 14 are based on state law.) Such state defenses must be raised in the state courts, if they are to be raised at all. The defense was not raised; the Hawaii court did not mention it as a possibility; this Court therefore must proceed on the assumption that, as a matter of state law, the wholesalers are the appropriate parties to recover the taxes they actually paid.[8] *O'Bannon* v. *Town Court Nursing Center*, 447 U. S. 773, 785 n. 17 (1980).

We also question whether, as a matter of federal law, a state *could* refuse to refund taxes paid by wholesalers in the circumstances of this case. See *Ward* v. *Love County*, 253 U. S. 17 (1920) (a state that collects taxes in violation of federal right must refund them, despite lack of state authority to refund). Many of this Court's cases applying the antidiscrimination principle of taxation are suits for refunds by middlemen (or, equivalently, efforts by middlemen to avoid punishment for refusal to pay taxes). From the very first case in this sequence,

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[7] The claim for damages prevents the case from being moot, even though the exemptions challenged have expired. *City of Pittsburgh* v. *Alco Parking Corp.*, 417 U. S. 369, 372 n. 2 (1974). Moreover, Hawaiian rum is exempted from current taxes, so that the propriety of favoritism of domestic products continues to be a live dispute among the parties.

[8] One reason why appellee neglected to raise the defense below may be that it has no apparent foundation in state law. This suit is based on two explicit refund statutes, each of which vests the person paying the tax with the right to a refund. Hawaii Rev. Stat. §§ 40-35, 244-8 (quoted in Br. in Opp. to Motion to Dismiss or Remand 4 n. 2). The Hawaii courts have not adopted the approach to refunds taken by the cases collected in n. 14 of appellee's brief.

this Court has held that the Commerce Clause creates a federal immunity insulating the middleman from the state's demand for payment. The definition of the federal right is that the merchant need pay no more tax on goods brought in from out of state than it pays on other goods. If the domestic tax is zero, so too is the tax on imported goods.[9] A state cannot override this federal immunity by its mere say-so.

The Court's decision to cast the federal right as an immunity from taxation at any level exceeding the tax on in-state goods reflects the difficulties in proving the economic incidence of any overcharge. The Tax Injunction Act, 28 U. S. C. § 1341, requires persons such as the appellants to litigate in state court their objections to state taxes. State laws, including Hawaii's, commonly require payment of the disputed taxes as a condition of litigation. As a result, the state will hold all taxes in question for the duration of the litigation. If a state can refuse to repay the taxes, even once the basis for their collection has been deemed unconstitutional, the state will not only keep the fruits of its improper action but also seriously discourage future litigation against its statutes. Even if the taxpayer shows that it bore much of the economic incidence of the tax, it will be unable to recover all of the overpayment.

Considerations of this sort led the Court to conclude that the direct payor of an overcharge in violation of the antitrust laws could recover the entire sum, trebled. *Hanover Shoe, Inc.* v. *United Shoe Machinery Corp.*, 392 U. S. 481 (1969). This is appropriate in part because an antitrust violation (like the

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[9] E.g., *James B. Beam, supra,* 377 U. S. at 343 (a refund suit by an importer of Scotch whisky; held that the Constitution creates a right to the refund); *Memphis Steam Laundry, supra,* 342 U. S. at 391 (Commerce Clause requires refund of taxes paid by a merchant); *Best* v. *Maxwell, supra* (same); *I.M. Darnell & Son Co.* v. *City of Memphis,* 208 U. S. 113 (1908) (Commerce Clause requires refund of taxes, paid under protest into registry of court, by a lumber mill that purchases logs from out of state); *Tiernan* v. *Rinker,* 102 U. S. 123, 127 (1880) ("A tax cannot be exacted for the sale of beer and wines when a foreign manufacture, if not exacted from their sale when of home manufacture"—this is the language of federal immunity from tax); *Guy* v. *Baltimore, suppa* (master of vessel cannot be prosecuted for failure to pay tax on goods brought in from another state); *Welton* v. *Missouri, supra* (peddler cannot be prosecuted for failure to pay tax on goods from out of state).

discriminatory tax) "takes from the [victim] more than the law allows" (392 U. S. at 489), and in part because in a complex economy it is almost inevitable that the direct payor of an overcharge (or tax) will bear some of the economic incidence of payment and pass the rest forward or backward. See also *Illinois Brick Co.* v. *Illinois,* 431 U. S. 720, 731-33, 741-43 (1977) (discussing the economics of incidence analysis); McLure, *Incidence Analysis and the Supreme Court: An Examination of Four Cases from the 1980 Term,* 1 Sup. Ct. Economic Rev. 69, 72-84 (1982) (same).

The economic incidence of a tax of the kind challenged here is very hard to determine. The 20% levy will lead Hawaiians to purchase less liquor from out of state; this reduction in demand will reduce the price out-of-state producers realize for their goods. See *Burke* v. *Ford,* 389 U. S. 320 (1967). Thus some of the incidence falls on producers. The levy also will lead wholesalers to reduce their markups, so as to maintain their sales, and to sell less; part of the incidence falls on the wholesalers. JA 16-17, 23 (showing how tax increases wholesalers' costs). The rest of the cost falls on retailers and customers. How much falls on whom depends on the elasticities of supply and demand.[10] *Illinois Brick, supra.* It is hard to

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[10] Appellee says (Br. 10-11) that the incidence falls on the retailers, because the wholesalers may elect to "separately state" the tax and require the retailers to pay. This Court has recognized, however, that economics, not nomenclature, determines who pays a tax. E.g., *Washington* v. *United States,* 460 U. S. ____ (No. 81-969, Mar. 29, 1983) ("it makes no difference to the contractor (or to the purchasers) which of them is required to pay the tax to the State, as long as they have the opportunity to allocate the burden among themselves by adjusting the price."). At all events, appellee's representation (Br. 11) that appellants *did* separately state the tax is not supported by the record (and, if we are to go outside the record, is not true). The record consists of the stipulations, which do not mention separate statement of tax. Separate statement gives the wholesaler an additional remedy (albeit one within the discretion of state officials) to collect only the fraction of the invoice price that represents taxes. It leaves the wholesaler liable for the full tax if the retailer does not pay on time. (The record shows that retailers often do not pay on time, see JA 15-16, 22.) The wholesaler must resort to ordinary commercial means to collect the rest of the bill. Thus wholesalers do not use the separate statement mechanism. They submit a single bill that includes all elements of the price.

find elasticities, and so it is hard to answer the incidence question. It is far better for the Court to hold, as a matter of federal law, that the person who pays a discriminatory tax may recover the whole tax. Any other approach reduces taxpayers' incentive to enforce the Constitution and increases states' incentive to levy improper taxes.

V. THIS COURT MAY NOT CURE THE CONSTITUTIONAL FLAW OF HAWAII'S TAX BY SEVERING THE EXEMPTIONS FOR LOCAL PRODUCTS

The state invites this Court to cure the unconstitutional discrimination by severing the exemptions for okolehao and fruit wine (and, one supposes, the new exemption for rum) in order to save the 20% tax (Br. 15-19). With the exemptions eliminated, appellee reasons, the constitutional infirmity of unequal treatment will be gone. There are two reasons, however, why the severability argument does not assist appellee.

First, severance is a method of construing a statute. A state statute is severable or not as a matter of state law. This Court cannot construe a state statute into oblivion in order to save it. Only the state court may modify its law so as to bring about the equal treatment the Constitution demands. *Stanton* v. *Stanton*, 421 U. S. 7, 17-18 (1975).

Second, even if this Court could sever the exemption for okolehao and fruit wine, it is too late for that remedy to be of any use. True, the wholesalers' federal right is to equal taxation. Elimination of the exemption thus would have been a perfect response to appellants' complaint—*if done in time to permit equal taxation.* But it was not. The okolehao and fruit wine exemptions expired in 1981. The injury of discriminatory taxation has taken place. The wrong is complete. The exemptions are defunct. There is nothing left to sever or save.

Even if Hawaii were to offer to go out and collect a 20% tax from wholesalers of okolehao and fruit wine—which the state

has not offered to do, for good reasons[11]—that would not be a sufficient remedy for the constitutional wrong. As we stressed above, discriminatory taxes lead wholesalers of out-of-state goods to reduce their margins on each sale and to sell less. Thus they suffer economic loss. A state's offer to collect taxes on domestic products some years later leaves that injury without redress. The offer to sever the exemptions also has all of the difficulties of the "passing on" defense discussed above. It is part of an effort by the state to keep the benefits of its wrong and to discourage merchants from litigating to vindicate constitutional rights. A state should not be permitted to create "remedies," such as severance after the statute has expired, that drain the federal rights of force. Cf. *Sullivan* v. *Little Hunting Park, Inc.*, 396 U. S. 229, 232-34 (1969); *Davis* v. *Wechsler*, 263 U. S. 22, 24-25 (1923) (state grounds may not be used to defeat federal rights).

VI. THE INVALIDATION OF HAWAII'S STATUTE SHOULD BE APPLIED TO THE APPELLANTS IN THIS CASE

The last of appellee's procedural arguments is a contention (Br. 19-22, 46-49) that any decision against the constitutionality of the state's statute should not be applied "retroactively" to allow appellants to recover. The state maintains both that sudden changes in the law should be applied prospectively (Br. 19-22) and that the recoveries sought here are too large to permit such unexpected payouts (Br. 46-49). The argument was not presented below and therefore is not properly before this Court. See page 2, *supra*. It is unavailing in any event.

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[11] Any attempt by Hawaii to collect taxes on okolehao and fruit wine for the period 1974 to 1981 (the time covered by appellants' applications for refund) would run into a serious problem: because state law did not purport to levy any tax on these products, the wholesalers that sold them would have a good defense to payment. The defense may be based on state law (want of authority to levy the tax, or statute of limitations) or on constitutional inhibitions on retroactive taxation. Moreover, some of the wholesalers of these products doubtless have gone out of business, so that collection would be impossible even if (which seems unlikely) the State possesses the records it would need to determine liability.

The state does not offer a standard "retroactivity" argument. A retroactivity problem may be presented by the *second* case that raises a problem; the Court must determine whether the rule laid down in case number one will be applied to other transactions that occurred before the date of the first decision. The answer to that question will turn on, among other things, the degree to which the first case upset settled expectations. But the *first* litigant prevails as of course. See *United States* v. *Johnson,* 457 U. S. 537 (1982) (surveying retroactivity doctrine). If the party that brought the first case were turned away without remedy, there would be little or no incentive to bring litigation. Here, for example, Hawaii would get to keep all of the proceeds of the discriminatory taxes. It has never been the function of retroactivity doctrine to insulate a state from *all* liability for wrongful levy of taxes.

On rare occasion the Court has refused to apply a rule in the very case announcing that rule. See *England* v. *Board of Medical Examiners,* 375 U. S. 411, 422-23 (1964). The justification advanced in such cases is that one party relied to its detriment on a line of authority and should not be penalized for this reliance, while at the same time nonretroactivity would not harm the other party. In *England,* for example, the refusal to apply a rule to the case simply permitted federal litigation of a federal right to proceed.

Hawaii cannot establish either reasonable reliance on settled doctrine or lack of prejudice to the appellants. It has been clear at least since 1875, when the Court decided *Welton,* that a state may not collect from a merchant a tax on out-of-state goods that exceeds the tax collected on domestic goods. It has been clear at least since 1897, then the Court decided *Scott* v. *Donald,* that the Wilson Act requires states to treat liquor from within and without the state equally. It has been clear at least since 1964, when the Court decided *Idlewild Bon Voyage Liquor* and *James B. Beam Distilling Co.,* that the Twenty-first Amendment does not give states absolute power over liquor or authorize discriminatory taxes of foreign liquors. Hawaii has been on notice since 1979 that the appellants deemed the state's discriminatory taxes to be unconstitutional under these cases.

From 1979 until it filed its brief in this Court, Hawaii has placed *no* reliance on the Twenty-first Amendment. It defended solely on the ground that protectionism is permissible state policy under ordinary Commerce Clause jurisprudence. This argument has been untenable for 109 years. Hawaii therefore cannot say that a decision in 1984 against the constitutionality of this tax would come as a shock. It has no legitimate reliance interests. Hawaii certainly cannot say that a failure in this case to recognize appellants' rights to freedom from discriminatory taxes would do no harm to appellants, which for years have been paying the taxes the state wrongfully demands of them.

These considerations also undercut the state's argument (Br. 46-49) that appellants should be sent away empty-handed because the state's refund liability is so large. A state that passes a discriminatory tax—in the teeth of cases holding that merchants need not pay the discriminatory levy—takes the risk that it will not get to keep the money. Hawaii took a large gamble. It cannot now seek shelter on the ground that it wagered more than it could afford to lose.[12]

Any "windfall" appellants will receive is attributable to the state's choices. Since 1979 the state has been on notice that the appellants considered the tax constitutionally defective. The state not only left the discrimination on the books but also enacted a new exemption, this time for rum. The legislature was warned that the exemption could well render the tax unconstitutional, but it enacted the exemption anyway. H. Conf. Rep. 13, 11th Sess. (1981), reproduced at McKesson Br. App. A-5. This new enactment strongly suggests that Hawaii has not been prejudiced by any lack of notice of constitutional

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[12] The state's brief repeatedly states that the refund liability to appellants exceeds $100 million. The stipulations in this case establish, however, that the state's liability to these appellants for back taxes as of September 27, 1979, would be a little more than $10.8 million (JA 7, 13). These sums would be larger today, given interest and the accumulation of new taxes since 1979. But they would not come close to $100 million.

problems.[13] The state simply desires to assist its domestic liquor business, even if it has to violate the Constitution to do so. A state that has allowed the discrimination to persist long after being warned of its failing, and as a result has reaped very large revenues, has no equitable ground to avoid repayment. A state cannot properly say that, because it has waited too long and let the taxes mount up, the amount in question is now too large to be paid back, so the state must be allowed to keep the revenues for itself.

CONCLUSION

For these reasons, in addition to those stated in our opening brief, the judgment of the Supreme Court of Hawaii should be reversed.

Respectfully submitted.

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[13] The fact that since 1979 Hawaii has placed the disputed taxes in escrow, and not counted on the escrowed fund for state operations, further demonstrates lack of prejudice.